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Introduction

Chairman Frank, Ranking Member Bachus, and members of the Committee, I appreciate the opportunity to be here today to discuss the importance of financial literacy, a topic that is particularly relevant in light of the turmoil in the mortgage market. This episode is challenging for financial institutions, communities, and families and has underscored how essential well-informed, financially savvy consumers can help ensure the financial well-being of individual households and the overall economy. My remarks today will address why financial education is vital to an efficient consumer financial marketplace, the challenges and opportunities for policymakers, regulators, and educators surrounding the design and delivery of financial education, and the Federal Reserve's ongoing commitment to financial education efforts.

The Current Financial Services Marketplace

As we all know, today's financial services industry is extremely diverse and complex. The application of new technologies, policies, and financial innovations has contributed to the development of a robust and highly competitive consumer finance marketplace. Consumers can choose among a wide variety of services and providers when conducting financial transactions that were once primarily offered through depository institutions, whether it is cashing a check or obtaining a mortgage loan.

These forces have also dramatically changed how financial services are marketed and delivered. Consumers no longer have to make a trip to a bank and wait a few weeks for a decision regarding a loan. Direct mail campaigns bring offers of credit to consumers' doors, and in some cases, credit can be applied for and granted by telephone or via the Internet. Credit scoring technologies have greatly streamlined consumer underwriting processes that have improved efficiencies in evaluating credit requests, from mortgage underwriting to credit granted immediately at retail registers. In addition, credit scoring technologies have changed the way credit is priced, with the cost of credit correlated with the risk a borrower represents as quantified by their credit score. This process of pricing has enabled lenders and investors to more closely align their risk tolerance with return requirements, which has resulted in the development of new credit markets for higher-risk borrowers.

Certainly, these developments have increased access to credit, particularly for those consumers who may not have been considered creditworthy 20 years ago. With these advancements, consumers can more readily establish a credit history. However, the rapid growth in the availability of credit has also brought increased responsibilities and risk to consumers, which makes it critical that consumers are well-informed about their personal financial circumstances and the products they contract for. Consumers must also be vigilant in shopping for their financial services. And, to be effective in evaluating products, they must be equipped with the knowledge required to ask the right questions, and to turn down a product that is not well-suited to their needs, especially a credit product. Consequently, the level of competition and complexity in today’s consumer financial marketplace highlights the need for effective financial education to help consumers evaluate and choose products that advance their financial well-being, not impede it.

The magnitude of mortgage delinquencies and foreclosures in recent months has underscored the importance of consumer understanding of financial products. A variety of factors contributed to the problems in the subprime mortgage market that financial education alone cannot address, and the need to assist homeowners in financial distress has clearly mobilized efforts to mitigate the devastating impact that mortgage delinquency has on consumers.

Government agencies at the local, state, and national levels, financial institutions, and nonprofit organizations are collaborating to develop strategies to assist troubled borrowers and minimize foreclosures. The focus of these efforts range from raising consumers' awareness of the resources that are available to them to working with servicers, lenders, and community organizations to restructure borrowers' mortgages into sustainable loans. Significantly, many of these initiatives have financial counseling and education as a core component. This fundamental element is critical to helping borrowers understand their financial situation and identifying the most viable solution for each borrower's circumstances.

Current market conditions make us attuned to the importance of financial counseling and education as they relate to managing mortgage credit, but mortgage delinquency is only one of the many scenarios that can precipitate a personal financial crisis. More often, households experience financial distress as the result of the loss of a job, a medical crisis, or a natural disaster. Financial education is an important tool for helping consumers to manage their personal finances and reduce their vulnerability to such unanticipated financial shocks.

Challenges of Designing and Delivering Financial Education

As policymakers and educators know, designing and delivering effective financial education presents numerous challenges. Among the most significant is that financial counseling and education are very resource-and-time intensive because of the individual nature of personal finances and the differing base of knowledge of consumers. In addition, there is a very broad range of potential audiences, and their educational and informational needs vary greatly, a challenge that is compounded by the rapid development of products targeted to specific market segments. This often requires the development of specialized programs to reach targeted audiences based on demographics, such as youth, young adults, or immigrant populations, or based on a consumer's stage in the financial lifecycle, such as preparing to fund higher education, buy a home, or prepare for retirement. Oftentimes, individuals in need of financial education may not have a fundamental understanding of financial management concepts, such as budgeting, saving, and credit. Financial education efforts may also be constrained by gaps in math and reading literacy, which impede comprehension of fundamental financial concepts.

Another challenge to delivering financial education is identifying the venue and delivery channels that facilitate consumers' participation in a program, as the demands of work and home often leave little time to give to such training programs. Language and cultural differences can also present challenges in reaching consumers who can benefit from financial education, particularly immigrant communities. Financial educators have worked diligently to design curricula to overcome these challenges and to present materials in a manner that suits a broad range of learning styles and preferences, from traditional classroom-style courses to telephone counseling and computer-based modules. As technologies and access continue to improve, financial educators have the opportunity to develop new strategies for delivering more effective programs.

The challenge of delivering financial education to youth can be as vexing as providing training programs to adults. One obvious solution would be to incorporate financial education into school curricula, which eight states have done by requiring that a course in personal finance be taken before graduating from high school. However, primary and secondary school teachers confront limited time and great demands in meeting current teaching requirements. And teachers themselves have expressed concern about their qualifications for providing financial education. To help address these challenges, many of the Federal Reserve Banks offer teaching materials on financial and economic education targeted to youth, as well as offer training sessions to teachers.

The workplace is another venue that offers promise for improving financial education. The Federal Reserve Board recognizes this opportunity. We regularly host seminars during the work day and encourage staff to take advantage of these sessions to learn more about benefits and retirement investment options.

Clearly, to be effective, counseling and education programs require trained instructors who have an understanding of the range of financial products and providers, and, in today's dynamic financial services marketplace, curricula must be regularly updated to remain relevant. Ideally, financial counseling would be available to consumers near the time at which they are making an important financial decision, such as whether to buy a home.

Despite these and the many other challenges, informed financial decisionmaking is vital for the healthy functioning of financial markets, in part because it stimulates competition that leads to improved products at better prices for consumers. In addition, research has demonstrated that financial literacy can lead to better outcomes for individual consumers. For example, a study of 14,000 recipients of credit counseling found that counseling had a positive effect on creditworthiness, especially for individuals with the lowest credit scores.[1] Another paper determined that new or recently delinquent credit cardholders were more likely to pay on time and to have lower revolving balances after receiving on-line instruction in credit management.[2] A study on consumer creditworthiness and consumer literacy concluded that financial knowledge is the single best predictor of behaviors, such as budgeting, saving, and

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[1] Gregory Elliehausen, E. Christopher Lundquist, Michael Staten (2003), "The Impact of Credit Counseling on Subsequent Borrower Credit Usage and Payment Behavior" (January), www.chicagofed.org/cedric/files/2005_conf_paper_session3_todd.pdf.

[2] Kimberly Gartner and Richard Todd (2005), "Effectiveness of Online 'Early Intervention' Financial Education for Credit Cardholders" (July), www.chicagofed.org/cedric/files/2005_conf_paper_session3_todd.pdf.

shopping responsibly, which translated into positive outcomes on credit bureau reports.[3] With these benefits and the implications they have for the broader economy, continued efforts in financial literacy are highly desirable. As a result, policymakers, regulators, researchers, and nonprofit organizations have examined their roles in financial education efforts and have worked to expand their contributions to helping consumers become better informed about managing their personal finances. Now let me talk briefly about the Federal Reserve's efforts in the financial education arena.

Federal Reserve System's Financial Education Efforts

The Federal Reserve has a long-standing commitment to providing information and education to help consumers make informed financial decisions.[4] Financial educational products and programs are offered by the Board and each of the twelve regional Federal Reserve Banks. Our services range from providing consumer educational resources to engaging in financial education collaborations at the national, regional, and local levels. We also conduct and promote research into consumer behavior and the efficacy of financial education programs to help inform policy and program design. We have established a centralized, dedicated website to improve accessibility to the financial and economic education resources offered by the Federal Reserve System at www.federalreserveeducation.org. I will provide examples of ways in which we have strategically contributed to financial education in each of these areas.

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[3] Marsha Courchane and Peter Zorn (2005), "Consumer Literacy and Creditworthiness" www.chicagofed.org/cedric/files/2005_conf_paper_session3_courchane.pdf.

[4] For a comprehensive listing of financial and economic education resources offered by the Federal Reserve System, see testimony on financial literacy by Chairman Ben Bernanke before the Committee on Banking, Housing, and Urban Affairs of the United States Senate May 23, 2006 at www.federalreserve.gov/newsevents/testimony/bernanke20060523a.htm.

Consumer Education Information Resources

The Federal Reserve has a long track record of providing consumer education publications that offer consumers accurate and objective information about financial products, as well as their rights under consumer protection laws and regulations. Our publications offer comprehensive information on the terminology of various products and questions to ask when shopping for financial services. For example, in relation to mortgage loans, we offer educational materials that address virtually all aspects of a mortgage transaction, from choosing a mortgage to understanding settlement costs to mortgage refinancing. To further help consumers in choosing a mortgage loan, we have developed a mortgage comparison calculator that is accessible on our website. This interactive tool allows consumers to compare the monthly payments and the equity accrual for several kinds of fixed and adjustable-rate mortgages. Most recently, we have posted a list of agencies and nonprofit organizations that provide foreclosure resources to homeowners struggling with their mortgages. We also offer a full range of resources on credit cards, deposit accounts, and other financial services. All of our consumer education resources are available on our website, and most are available in Spanish.

Similarly, each of the Federal Reserve Banks develops financial education materials that are responsive to their local and regional markets' information needs. For example, the Federal Reserve Bank of Atlanta offers "Katrina's Classroom: Financial Lessons from a Hurricane," an on-line curriculum for high-school students on the importance of financial planning and preparedness. The Federal Reserve Bank of Boston has established a dedicated website at www.theinformedhomebuyer.org to help consumers access regional and national resources related to mortgage delinquency and foreclosures.

Leadership in Financial Education Collaborations

The Federal Reserve System also commits significant resources to providing leadership and technical assistance to financial education initiatives. Here in Washington, Board staff serve in advisory positions to the Jump$tart Coalition, America Saves campaign, and National Council on Economic Education. In addition, the Federal Reserve is a member of the Financial Literacy and Education Commission, with staff serving on two of the commission's three working groups--the National Strategy Working Group and the Mymoney.gov Website Working Group.

Similarly, the Federal Reserve Banks work with educators and community organizations in their Districts to further financial education. Many of the Reserve Banks partner with organizations to provide "teach the teacher" and "train the trainer" programs to help ensure that financial and economic educators have the knowledge and information resources they need to be effective in their roles. The Federal Reserve Bank of St. Louis is an active partner in the Gateway to Financial Fitness program, a 12-week general financial education program targeted at lower-income consumers. In addition, the Federal Reserve Bank of Boston provides training and volunteers to work with Volunteer Income Tax Assistance sites in the region to help lower-income individuals file their taxes and apply for tax refunds through the Earned Income Tax Credit program. In San Francisco, the Reserve Bank is engaged in a broad-based collaboration that provides financial education and other support to help bring the city's unbanked into the financial mainstream.

The Federal Reserve System also works to increase awareness of the importance of financial literacy. For example, the Federal Reserve Bank of Chicago hosts a "MoneySmart Week" throughout its District for each week of April. The Reserve Bank collaborates with local organizations to host a series of free classes and activities designed to help consumers better manage their personal finances. The Federal Reserve System also works to improve the infrastructure for financial education networks and resources. In recent years, staff of the Federal Reserve Banks of Minneapolis and Kansas City were integral to establishing statewide chapters of Jump$tart in Montana and Nebraska, while the Federal Reserve Bank of Cleveland has led efforts to establish regional financial education coalitions to leverage resources and share best practices.

Over the last year, the Federal Reserve System has leveraged its numerous financial education partnerships to sponsor conferences and roundtables about financial education and counseling for communities working to support borrowers experiencing distress from their mortgage situations. These forums have been instrumental in sharing information resources and understanding and responding to borrowers' needs.

Research on Financial Education Programs

Given the scarce resources available to provide financial education, it is important to ensure that they are being used effectively. Accordingly, the Federal Reserve is committed to conducting and promoting research on the efficacy of financial education programs. Our biennial Community Affairs Research Conference is a regular source for generating and presenting the most recent research on financial education programs. In addition, the Federal Reserve Bank of Philadelphia is engaged in a research collaboration to conduct a long-term study of the effectiveness of pre-purchase homeownership counseling and its effect on consumer credit behavior and homeownership. In recent months, the Federal Reserve Bank of Boston has published the results of a study examining the characteristics of individuals who self-select into financial education programs.[5]

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[5] Stephan Meier and Charles Sprenger, (2007) "Selection into Financial Literacy Programs: Evidence from a Field Study, (No. 07-05), November 2007, http://www.bos.frb.org/economic/ppdp/2007/ppdp0705.htm.

In addition to our various research efforts, we have also gained valuable insight into consumers' information needs and shopping behaviors directly from consumers. Over the last several years, the Board has engaged in extensive consumer testing of disclosures for privacy notices, credit cards, and mortgages in conjunction with our rule-writing efforts for these products. The information we have gained from these sessions has helped us to better understand how consumers shop for financial products and services and what information they need to make their decisions. Our experiences with consumer testing underscore the importance of providing content that consumers need and of refraining from emphasizing form over substance. For example, focusing on the length of disclosures could limit the ability to provide information essential to consumers' decisionmaking process. Such feedback gained through consumer testing can also inform the design of financial education programs.

Conclusion

In closing, I would like to emphasize that the Federal Reserve will continue to maintain its commitment to financial education. Financial education is essential to helping consumers make well-informed and beneficial decisions that enhance their financial positions and enhance efficiencies in the consumer financial marketplace. Financially educated consumers are an important first line of defense in well-functioning markets. At the same time, it is important to recognize that financial education is not a panacea, and that there remains a need for effective regulation that is responsive to market evolutions to ensure that consumers are protected against abusive and fraudulent practices by unscrupulous players.

Interest in consumer financial education continues to grow, at both the national and international level. This brings the promise of new resources and ideas that can help overcome the challenges of developing and delivering effective financial education to diverse audiences with diverse needs. This increased commitment can also help to improve coordination and to leverage resources that will improve efficiencies and spur innovation in the field. I remain optimistic that this dedication will lead to improved financial literacy outcomes that will benefit consumers, communities, and the broader economy.